

## Internal Revenue Service

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TY:

### Legend

Parent =

Taxpayer =

Taxpayer 1 =

Subsidiary =

Date a =

Date b =

Date c =

Date d =

Years at Issue =

Year 1 =

Year 2 =

Tax Consultant =

Tax Service =

Provider

Trusts =

Dear :

This letter is in response to a ruling request dated December 4, 2012, submitted on behalf of the Taxpayer, and Taxpayer 1, (Taxpayers) requesting an extension of time to make a consent dividend election under § 565 of the Internal Revenue Code. The request was made pursuant to §§ 301.9100-1 and 301.9100-3 of the Procedure and Administration Regulations.

## FACTS

On Date a, Parent incorporated Taxpayer, and Taxpayer issued common and preferred stock. Parent owned all of the common stock. Taxpayer elected to be treated as a Real Estate Investment Trust (REIT) on its first tax return. Parent sold Trusts, including real estate mortgage investment conduits (REMICs) and REIT taxable mortgage pools (REIT-TMPs), to Taxpayer on Date b. On Date c, Taxpayer 1 acquired Parent. Subsequent to the acquisition, Taxpayer 1 converted Parent to a Limited Liability Company (LLC) treated as a disregarded entity. Consequently, after the conversion Taxpayer 1 treated itself as directly holding the common stock of Taxpayer, initially held by Parent. On Date d, additional voting common stock of Taxpayer and a de minimus amount of nonvoting preferred stock was issued to the Subsidiary, a member of Taxpayer 1's consolidated group. Consequently, at all times after the acquisition of Parent, Taxpayer 1 and Subsidiary owned at least % of the total voting power and at least % of the total value of the stock of Taxpayer. However, because Taxpayer elected to be treated as REIT on its first tax return, it cannot be an includable corporation of Taxpayer 1's consolidated group.

Taxpayer timely filed all of its federal income tax returns (Form 1120-REIT) for its first year of operation as well as the Years at Issue. All of the returns for the Years at Issue have been prepared by Taxpayer 1. In preparing the returns, Taxpayer 1 relied on information provided by the Tax Service Provider and one other company. Taxpayer 1 used the quarterly balance sheet information provided by the Tax Service Provider to prepare its and Taxpayer's financial statements as well as Forms 1120-REIT of Taxpayer.

The Tax Service Provider did not have an explicit obligation to calculate excess inclusion income with respect to the REIT-TMPs, and, although individuals at the tax department of Taxpayer 1 were aware of the tax considerations generally applicable to REITs, they were unaware that special rules might apply to mortgage REITs regarding excess inclusion income, and believed that information regarding the taxable income and expense of Trusts provided by the Tax Service Provider was sufficient for purposes of calculating Taxpayer's income.

In addition, although the Tax Service Provider computed excess inclusion income with respect to Year 2 and reported the amounts of excess inclusion income to Taxpayer on Schedule Q, the individuals who prepared Taxpayer's Form 1120-REIT for the Years at Issue were not aware that the excess inclusion income from the REMIC residual interests required special treatment for federal income tax purposes. As a result, Taxpayer's Form 1120-REIT for each of the Years at Issue was prepared without regard to the requirement that taxable income may not be less than excess inclusion income.

Tax Consultant has been providing professional tax services to Taxpayer 1 for a number of years. However, for the Years at Issue Taxpayer 1 did not engage Tax Consultant to assist in the preparation of Taxpayer's federal income tax return. Under the scope of general tax consulting contract, Tax Consultant reviewed calculations of Taxpayer's taxable income and its compliance with the REIT qualification tests for the Years at Issue. In the course of its review, Tax Consultant noticed that Taxpayer 1 had received Schedule Qs from Tax Service Provider for REMIC residual interests owned by Taxpayer, and that Tax Service Provider had indicated the amounts of excess inclusion income. Tax Consultant asked the Taxpayer 1's tax department whether excess inclusion calculations had been performed and was informed that none of the individuals involved in preparing Taxpayer's income tax returns had been aware of the need to calculate excess inclusion income for the REIT-TMPs. Accordingly, no calculations of excess inclusion income from the REIT-TMPs were performed during the Years at Issue, and Taxpayer filed Form 1120-REIT for each of those years without regard to the requirement that taxable income cannot be less than excess inclusion income.

Taxpayer reported losses in each of the Years at Issue, and the amount of loss for each of the years was larger than the subsequently calculated amount of excess inclusion income for that year. In order to distribute excess inclusion income to its common shareholders, Taxpayer would have needed to make a deemed distribution pursuant to a consent dividend election. However, consent dividend elections for excess inclusion income from the REIT-TMPs and REMICs for the Years at Issue were not made timely. Consequently, Taxpayer wishes to elect to make consent dividends for excess inclusion income from REIT-TMPs and REMICs for the Years at Issue. The consent dividends would be deemed paid to Taxpayer 1 and Subsidiary in proportion to their holdings of Taxpayer's common stock during those years.

## LAW AND ANALYSIS

Section 565(a) provides that if any person owns consent stock (as defined in § 565(f)(1)) in a corporation on the last day of the taxable year of such corporation, and such person agrees, in a consent filed with the return of such corporation in accordance with the regulations, to treat as a dividend the amount specified in such consent, the amount so specified shall, except as provided in § 565(b), constitute a consent dividend for purposes of § 561 (relating to the deduction for dividends paid). Consent stock includes what is generally known as common stock and participating preferred stock, the participation rights of which are unlimited. Section 1.565-6 of the Income Tax Regulations.

Section 1.565-1(a) provides that the dividends paid deduction, as defined in § 561, includes the consent dividends for the taxable year. A consent dividend is a hypothetical distribution (as distinguished from an actual distribution) made by certain corporations to any person who owns consent stock on the last day of the taxable year of such corporation and who agrees to treat the hypothetical distribution as an actual

dividend, subject to specified limitations, by filing a consent at the time and in the manner specified in § 1.565-1(b). Section 1.565-1(b)(3) provides that a consent may be filed not later than the due date (including extensions) of the corporation's income tax return for the taxable year for which the dividends paid deduction is claimed. With such return, and not later than the due date, the corporation must file Forms 972 for each consenting shareholder, and a return on Form 973 showing by classes the stock outstanding on the first and last days of the taxable year, the dividend rights of such stock, distributions made during the taxable years to shareholders, and give all other information required by the form.

Section 301.9100-3 generally provides extensions of time for making regulatory elections. For this purpose § 301.9100-1(b) defines the term "regulatory election" to include an election whose deadline is prescribed by a revenue ruling, revenue procedure, notice or announcement published in the Internal Revenue Bulletin.

Section 301.9100-3 provides that requests for extensions of time for regulatory elections will be granted when the taxpayer provides evidence (including affidavits described in paragraph (e) of this section) to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith and granting relief will not prejudice the interests of the government.

Section 301.9100-3(b)(1) states that a taxpayer will be deemed to have acted reasonably and in good faith if the taxpayer --

- (i) requests relief before the failure to make the regulatory election is discovered by the Service;

- (ii) inadvertently failed to make the election because of intervening events beyond the taxpayer's control;

- (iii) failed to make the election because, after exercising due diligence, the taxpayer was unaware of the necessity for the election;

- (iv) reasonably relied on the written advice of the Service; or

- (v) reasonably relied on a qualified tax professional, and the tax professional failed to make, or advise the taxpayer to make, the election.

The affidavits presented show that Taxpayer acted reasonably and in good faith, having requested relief before the failure to make the election was discovered by the Service.

Under § 301.9100-3(b)(3), a taxpayer will not be considered to have acted reasonably and in good faith if the taxpayer --

- (i) seeks to alter a return position for which an accuracy-related penalty has been or could be imposed under § 6662 at the time the taxpayer requests relief (taking into account § 1.6664-2(c)(3) of the Income Tax Regulations) and the new position requires a regulatory election for which relief is requested;

- (ii) was informed in all material respects of the required election and related tax consequences, but chose not to file the election; or

(iii) uses hindsight in requesting relief. If specific facts have changed since the original deadline that make the election advantageous to a taxpayer, the Service will not ordinarily grant relief.

Taxpayer has represented that it is not seeking to alter a return position for which an accuracy-related penalty has been or could be imposed under § 6662 at the time Taxpayer requests relief. Furthermore Taxpayer has represented that it is not using hindsight in requesting relief and that specific facts have not changed since the original deadline that made the election advantageous to Taxpayer.

Section 301.9100-3(c)(1)(i) provides, in part, that the interests of the government are prejudiced if granting relief would result in the taxpayer having a lower tax liability in the aggregate for all taxable years affected by the election than the taxpayer would have had if the election had been timely made (taking into account the time value of money). Section 301.9100-3(c)(1)(ii) provides, in part, that the interests of the government are ordinarily prejudiced if the taxable year in which the regulatory election should have been made, or any taxable years that would have been affected by the election had it been timely made, are closed by the period of limitations on assessment. Under these criteria, the interests of the government are not prejudiced in this case.

Based on our analysis of the facts and representations, Taxpayer acted reasonably and in good faith, and granting relief will not prejudice the interests of the government. Therefore the requirements of § 301.9100-1 and § 301.9100-3 have been met.

Accordingly, the consent of the Commissioner is hereby granted for an extension of time to amend the § 565 consent dividend election for the Years at Issue. This extension shall be for a period of 45 days from the date of this ruling. Please attach a copy of this ruling to the returns, schedules and forms filed in connection with making the election under § 565 when such forms are filed. We enclose a copy of the letter for this purpose. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for ruling, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is hereby expressed or implied regarding whether Taxpayer otherwise qualifies as a REIT under subchapter M of the Code or regarding the accuracy of Taxpayer's excess inclusion income calculations. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Lewis K Brickates  
Chief, Branch 1  
(Income Tax & Accounting)

cc: